

Ensuring continuity of critical clearing services: the Bank of England's approach to discretionary payments by central counterparties

Consultation paper

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Responses are requested by Friday 17 November 2023.

Please address any comments or enquiries by email to: ✉ CCPdiscretionarypayments@bankofengland.co.uk.

Alternatively, please address any comments or enquiries to: Financial Market Infrastructure Directorate, Bank of England, 20 Moorgate, London, EC2R 6DA.

1: Overview

This consultation paper (CP) sets out the Bank of England's (the Bank's) proposed approach to its power to temporarily restrict or prohibit discretionary payments to shareholders or employees^[1] of recognised UK central counterparties (referred to as 'CCP' or 'CCPs' in this CP)^[2] in severe circumstances. This CP is relevant for those same CCPs, which are supervised by the Bank and could be subject to directions given by the Bank under this power. This power does not apply to third-country CCPs offering services in the UK.

The power to temporarily restrict or prohibit discretionary payments to shareholders or employees of CCPs is a new power conferred upon the Bank by the Financial Services and Markets Act 2023 (the Act), which requires the Bank to publish a statement of its policy with respect to giving directions under this power. This CP proposes and consults on the Bank's draft statement of policy (SoP) 'Ensuring continuity of critical clearing services: the Bank of England's approach to discretionary payments by central counterparties' (appendix).

The proposals set out in this CP are:

- the Bank's proposed approach to the statutory conditions for the use of the power, including circumstances for giving a direction to restrict or prohibit discretionary payments; and
- the proposed process for giving any direction under this power.

The proposed SoP seeks to clarify the types of factors the Bank may consider in assessing the statutory conditions for the use of the power, the types of circumstances that could lead to the statutory conditions being deemed to be met, and the Bank's approach to the use of the power to support its objective to protect and enhance UK financial stability through ensuring the continuity of critical clearing services. This CP does not consult on the scope of the power itself as this is set and conferred upon the Bank by the Act. The Bank would like to invite views on its proposed approach to exercising the power as outlined below and in the draft SoP.

In developing the proposals in this CP, the Bank has considered its objective to protect and enhance the financial stability of the UK, its statutory obligations and other relevant considerations, including the Bank's considerations on the costs and benefits of the proposals. The proposals in this CP seek to provide transparency and avoid circumstances where the Bank's use of the power to restrict or prohibit discretionary payments may give rise to an undue burden. The Bank considers that its proposed approach would not place an undue burden on firms and that the proposed approach is aligned with the Bank's financial stability objective.

Background

Schedule 11 of the Act makes provision for a special resolution regime for CCPs and grants the Bank additional powers that support its financial stability objective. This provision aims to maintain the continuity of critical clearing services, preventing contagion and limiting the risks to public funds should a CCP enter into financial difficulties. The Act received Royal Assent on 29 June 2023. [HM Treasury consulted on these powers](#), including the power relevant to this CP, in February to May 2021.

The additional powers under Schedule 11 of the Act include new powers relating to CCPs which enable the Bank to act before the special resolution regime is triggered. This CP relates to one such power, the power to temporarily restrict or prohibit discretionary payments to specified shareholders or employees of CCPs in severe circumstances. This power is set out in paragraph 13 of Schedule 11 of the Act. Subject to certain statutory conditions (outlined in Section 2 of this CP), the power enables the Bank to, once the conditions are met, give directions requiring CCPs to restrict or prohibit certain types of discretionary payments for a period of up to five years.

The types of 'discretionary payments' which may be temporarily restricted or prohibited are payments, made otherwise than under a contractual obligation, of dividend payments; share buy-backs; equity remuneration; and variable remuneration including, where an employee is a senior manager,^[3] bonuses, discretionary pension benefits and severance payments.

Paragraph 14 of Schedule 11 outlines the process by which the Bank must review any directions given under this power. Any direction must be reviewed at least once every three months and must be revoked if, at any time, the Bank determines that the conditions for the use of the power cease to be met. Any direction ceases to have effect if a stabilisation power^[4] is exercised with respect to the relevant CCP.

In June 2020, Deputy Governor for Financial Stability Sir Jon Cunliffe wrote a ['Dear CEO' letter to UK financial market infrastructures](#) (FMIs) highlighting the need to take account of any additional risks and potential financial and operational demands arising from Covid-19 when considering such discretionary payments. The aim of this was to encourage CCPs and other FMIs to retain funds, which otherwise would have been used for dividend payments and variable remuneration, to help ensure their financial resources continued to be sufficient during stress, absorb any potential losses and maintain the critical services they provide. CCPs are required to maintain a minimum quantum of funds to ensure they can continue operations as a going concern. A direction under this power to restrict or prohibit discretionary payments would have the aim of supporting the Bank's financial stability objective by helping to ensure that CCPs can use additional liquid resources to help absorb potential losses in situations of stress and uncertainty.

HM Treasury's consultation, issued February 2021, followed by the consultation response, issued March 2022, noted that the power introduces the ability for the Bank to use this power in a range of severe circumstances, including if there is a significant deterioration in the financial situation of the CCP and it was therefore at risk of failing. The range of circumstances in which the Bank can use the power is set by the statutory conditions (set out in Section 2 of this CP).

This CP is set out as follows: Section 2 sets out the Bank's proposals for its approach to temporary restrictions of discretionary payments for CCPs as set out in the proposed SoP in the appendix. Section 3 sets out how the Bank has taken into account its financial stability objective, statutory obligations and other relevant considerations, including the Bank's analysis of the costs and benefits of the proposals.

Implementation

The Bank intends to publish the final SoP (appendix) in 2024 Q1. The Bank proposes that the final SoP enter into effect upon publication.

Responses and next steps

This consultation closes on Friday 17 November 2023. The Bank invites feedback on the proposals set out in this consultation. Please address any comments or enquiries to ✉ CCPdiscretionarypayments@bankofengland.co.uk. Please indicate in your response if you believe any of the proposals in this CP are likely to impact persons who share protected characteristics under the Equality Act 2010, and if so, please explain which groups and what the impact on such groups might be.

2: The Bank's proposals

The Bank views the power to temporarily restrict or prohibit discretionary payments to specified shareholders or employees of CCPs (jointly referred to as 'restrictions' in this CP) as an important measure for use in severe circumstances that supports its objective to protect and enhance UK financial stability. Temporary restrictions of discretionary payments can help CCPs to use these additional funds to ensure their financial resources continue to be sufficient to maintain the continuity of critical clearing services in periods of stress and uncertainty where CCPs may face greater risks to their financial and operational resilience.

The Bank considers this power as an important component of its supervisory toolkit, which can support a CCP's financial resilience in times of stress or uncertainty to help ensure the continuity of critical clearing services. The Bank's ability to use the power is limited to severe circumstances set by the statutory conditions. In 2020, with the heightened uncertainty driven by the onset of the Covid-19 pandemic, the Bank communicated to UK FMIs that it expected UK FMIs' boards to take into account the risks to the FMI's financial and operational resilience that had arisen, or could potentially arise, from Covid-19 in any decision-making around distribution of profits. The power under paragraph 13 of Schedule 11 of the Act will enable the Bank, subject to certain conditions (outlined below), to direct CCPs to temporarily restrict or prohibit discretionary payments to shareholders or employees of CCPs to ensure that CCPs can use additional liquid resources to absorb potential losses and ensure continuity of critical clearing services in situations of stress and uncertainty.

The Bank's proposed approach to giving a direction to restrict or prohibit discretionary payments

The Act^[5] sets out the conditions that the Bank must deem to be met before the Bank may exercise the power. These conditions set the scope for the type of severe circumstances in which the Bank might use the power. The proposed SoP (appendix) sets out the Bank's approach to assessing these statutory conditions,

and the types of circumstances in which the Bank may deem the conditions to be met and may consider using the power to give a direction to restrict or prohibit discretionary payments.

First, the Act stipulates that the power can only be used provided that no stabilisation power is being exercised in relation to the CCP. As such, any direction under this power would be given by the Bank as supervisor of CCPs. The Act also provides an equivalent power (paragraph 102 of Schedule 11), which enables the Bank, as Resolution Authority, to temporarily restrict or prohibit discretionary payments to specified shareholders or employees of CCPs in a resolution context. The approach set out in this CP, and the draft SoP, does not apply to the Bank's use of the power in paragraph 102. The conditions that need to be met to use the power set out in paragraph 13 do not apply to the power in paragraph 102.

Second, the use of the power must be necessary or desirable, having regard to the public interest in UK financial stability or the continuity of critical clearing services. The Bank considers the continuity of critical clearing services to be of critical importance in maintaining public confidence in the UK financial system. Furthermore, the Bank regards periods of stress and uncertainty that could affect the continuity of critical clearing services or create system-wide effects that impact UK financial stability to be likely scenarios that may warrant the Bank's use of the power. The Bank proposes a holistic approach to assessing whether its use of the power would mitigate risks to UK financial stability or ensure the continuity of critical clearing services to maintain public confidence in the wider financial system that the CCP serves.

Finally, the Bank will need to assess whether at least one of a set of conditions, set out in paragraph 13(3) of Schedule 11, have been met:

Condition I: There is or is likely soon to be a significant deterioration in the financial situation of the CCP.^[6]

Condition II: There is a material risk of a threat to the ability of the CCP to maintain critical clearing services.^[7]

Condition III: There is a risk of a significant disruption to the operation of the CCP.

Condition IV: The operation of the CCP poses a risk to the financial stability of the United Kingdom.

In its assessment of Conditions I to IV, the Bank will consider the scale of any disruption to the operation or financial situation of the CCP and its potential effects on the CCP's ability to maintain critical clearing services. The Bank's proposed approach also takes into account the potential impact that restrictions of different types of discretionary payments may have. The Bank's proposed approach, as set out in the draft SoP, is therefore based on a targeted use of the power determined on a case-by-case basis. Given the relative total amounts of different types of discretionary payments, in certain circumstances restricting dividend payments is likely to be more effective in improving the financial situation of the CCP to help ensure continuity of critical clearing services than restricting other types of discretionary payments, such as equity remuneration. This may mean restricting only specific types of discretionary payments, while allowing other discretionary payments to proceed, in particular where the Bank considers that restricting certain types of payments could have an adverse impact on the operation of the CCP or its ability to maintain critical clearing services.

The Bank proposes to consider Conditions I to IV, of which at least one has to be met, concurrently during its assessment, as there may be circumstances where more than one of these conditions may be met. The Bank considers that its decision that at least one of Conditions I to IV is met will be based on the specific circumstances at the time. The draft SoP sets out non-exhaustive hypothetical examples of the types of circumstances where the Bank may consider that one, or more, of Conditions I to IV are met. These include, but are not limited to:

- major risks to UK financial stability that the Bank judges could transmit to a CCP;
- a shock to a CCP that results in material financial losses; and
- unanticipated material general business risks to a CCP.

The Bank's proposed approach allows that despite the statutory conditions being deemed to be met the Bank may decide not to use the power. If the conditions are met and the Bank decides to exercise the power, the Act provides the Bank with the discretion to decide which types of discretionary payments are to be restricted or prohibited. The Bank's proposed approach recognises that it may be disproportionate to issue blanket restrictions on all types of discretionary payments.

In line with the objective of the power, the Bank would only restrict, or prohibit, those discretionary payments where the Bank considers that its direction would mitigate risks to the stability of the UK financial system through ensuring continuity of critical clearing services.

The Bank will provide any direction issued under this power in writing. The direction will specify the shareholders and/or employees that the direction applies to. The Bank proposes that the direction include, but not necessarily be limited to, information on the reason for the Bank's use of the power, the duration of any direction remaining in force, and the types of payments captured by the scope of the restriction. Any direction may be varied at the Bank's discretion, will be reviewed every three months and will be subject to a time limit of five years as provided by the Act.

The Bank is not required to publish directions. The Bank considers that, depending on the specific circumstances that prompted the Bank to use the power, the Bank may not consider it beneficial to financial stability to publish the direction or information on the direction. For example, the Bank may, in some circumstances, consider issuing a public statement to the effect that a direction has been issued under this power to help ensure continuity of critical clearing services and maintain UK financial stability, without publishing the direction itself.

3: The Bank's financial stability objective, statutory obligations and cost benefit analysis

The relevant considerations that the Bank has considered in developing the proposals in this CP are set out in this section, including with respect to its financial stability objective, statutory obligations, and cost benefit analysis.

Bank objective analysis

The Bank has an objective to protect and enhance the stability of the financial system in the UK.^[8] The proposals in this CP are aligned with this objective and are intended to safeguard UK financial stability through ensuring the continuity of critical clearing services. The Bank's proposed approach in the draft SoP sets out how the Bank would seek to safeguard UK financial stability through the use of the power to temporarily restrict or prohibit discretionary payments in severe circumstances.

Equality and diversity

The Bank is required by the Equality Act 2010^[9] to have due regard to the need to eliminate discrimination and to promote equality of opportunity in carrying out its policies, services, and functions. The Bank considers that the proposals in this CP would not give rise to adverse equality and diversity implications. The Bank's proposed approach sets out the impact of the specified discretionary payments on the financial situation of the relevant CCP as the relevant factor in the Bank's assessment and any decision of the potential use of the power.

Cost benefit analysis

The proposals in this CP seek to provide transparency regarding the Bank's approach to the use of its power to temporarily restrict or prohibit discretionary payments of specified shareholders or employees of CCPs in severe

circumstances. The proposed approach sets out the factors that the Bank would expect to consider in assessing whether exercising the power is necessary or desirable and whether the statutory conditions for its use have been met.

The Bank's proposed approach advances the objective of the power as set out in the draft SoP. The Bank considers that its proposals would benefit UK financial stability, subject to the necessary conditions, by ensuring that, should a relevant incident occur, the CCP can retain additional funds to help absorb shocks during periods of stress and uncertainty in order to support its ability to maintain critical clearing services. The Bank's proposed approach supports the aim of the power to avoid the disruption of critical clearing services, which can support market sentiment regarding CCPs and mitigate stress on the wider financial system.

The Bank recognises that CCPs will need to familiarise themselves with the Bank's proposed approach set out in the draft SoP and its potential implications for the non-contractual discretionary payments it makes to its shareholders and employees. CCPs should understand which types of payments could be restricted or prohibited and how this would affect its shareholders and employees. The Bank considers that the costs of familiarisation with the Bank's proposed SoP should be minimal, and no additional financial costs are expected on a business-as-usual basis.

The Bank's proposed approach intends for the power to be used in severe circumstances, for example acute stress or uncertainty, rather than as a business-as-usual requirement and, as provided by the Act, only non-contractual discretionary payments fall within its scope. Should a direction be given by the Bank based on the approach proposed in this CP, the scope and duration of the restriction will be determined by and proportionate to the scope of the incident and the degree of uncertainty. The Bank will assess the statutory conditions and its use of the power on a case-by-case basis.

In developing its proposals, the Bank has considered a number of factors. For example, whether restricting discretionary payments would hinder the CCP's ability to retain and attract key staff needed to ensure the continuity of critical clearing services. If so, the Bank can, as a partial mitigant, exercise discretion in its use of the power and in the scope of the restriction. The draft SoP provides for such a discretionary approach. Where discretionary payments are temporarily restricted or

prohibited but ultimately those funds are not needed and the direction is no longer in effect, the CCP could decide to issue these discretionary payments to affected shareholders and/or employees. This may therefore result in a temporary impact on the affected shareholders and/or employees, as the restriction of the specified discretionary payments would cause a temporary transfer of value in favour of the CCP in order to mitigate risks to UK financial stability following a stress event. The Bank must review the direction at least every three months, and once the statutory conditions for exercising the power cease to be met, the Bank must revoke the direction with immediate effect.

The Bank considers that its proposals align with both the objective of the power, ie to protect and enhance UK financial stability through ensuring continuity of critical clearing services, and the scope of power, ie that only non-contractual discretionary payments may be restricted or prohibited. Any restrictions would be time limited and be given only in severe circumstances as ensured by the statutory conditions. Therefore, the Bank considers that, on balance, the impact of the Bank's proposed approach is likely to be minimal, and that the benefits of the Bank's proposals outweigh the costs.

Appendix: draft statement of policy

Ensuring continuity of critical clearing services: the Bank of England's approach to discretionary payments by central counterparties

This appendix contains the Bank of England's proposed policy for exercising its power to give directions to restrict or prohibit discretionary payments to specified shareholders or employees of a CCP for a specified period under Schedule 11, paragraph 13 of the Financial Services and Markets Act 2023.

1: Introduction

This statement of policy (SoP) sets out the Bank of England's (the Bank's) approach to giving directions to temporarily restrict or prohibit discretionary payments to specified shareholders or employees^[10] of recognised UK central counterparties (CCPs)^[11] in severe circumstances. This power is conferred by the Financial Services and Markets Act 2023 (the Act).^[12] The Act requires the Bank to publish a statement of its policy with respect to giving directions under this power. This SoP is relevant to recognised UK CCPs supervised by the Bank – henceforth referred to as 'CCP' or 'CCPs' in this SoP.

The Bank views this power as an important measure to ensure the continuity of critical clearing services in times of acute stress and uncertainty,^[13] which supports the Bank's objective to protect and enhance UK financial stability. The exercise of this power to direct CCPs to retain funds that may otherwise be paid to, for example, shareholders or senior managers of CCPs could support this objective, should the statutory conditions for the use of this power be met. The Bank's ability to use the power is limited to severe circumstances set by the statutory conditions in the Act. This is reflected in the approach set out in this SoP.

This SoP is set out as follows. Section 2 sets out the background and statutory framework of the power. Section 3 sets out the Bank's approach to giving directions under the power and the conditions under which the Bank may use the power. Section 4 sets out the format and process the Bank will follow when giving directions under the power.

2: Background and statutory framework

CCPs play an important role in the functioning of financial markets through the critical services they provide. CCPs therefore play a crucial role in safeguarding financial stability. CCPs interpose themselves between the counterparties to contracts traded on one or more financial markets – becoming the buyer to every seller and the seller to every buyer. This ensures that the obligations of a trade can be fulfilled even if one counterparty fails, thus reducing counterparty credit risk in financial markets.

Given the crucial role of CCPs in the financial system, it is important that CCPs maintain appropriate levels of resilience and have comprehensive arrangements in place to manage the default of one or more of its clearing members and other losses. CCPs are required to maintain recovery plans. Should these recovery plans be ineffective in ensuring the continued viability of the CCP, there is a process by which the Bank, as Resolution Authority, can intervene when recovery fails, or is likely to fail. The Act includes a special resolution regime for CCPs, which is aimed at limiting the risk to public funds, ensuring continuity of critical clearing services, and preventing contagion to the wider market.

Power to temporarily restrict or prohibit discretionary payments

The Act also introduces additional powers for the Bank, under its responsibilities to supervise financial market infrastructures (FMIs) including CCPs. This includes the power to temporarily restrict or prohibit CCPs from making certain discretionary payments to specified shareholders or employees of the CCP – jointly referred to as ‘restrictions’ in this SoP. This power the Bank can only use when no stabilisation powers are being exercised by the Bank, as Resolution Authority, in relation to the CCP in question. It is aimed at maintaining and enhancing the resilience of the CCP in severe circumstances such as when there is a material risk of a threat to the ability of the CCP to maintain critical clearing services. There is an equivalent power to similarly restrict or prohibit discretionary payments in a resolution context – the Bank’s use of that power (paragraph 102 of Schedule 11 of the Act) is not covered by this SoP.

Paragraph 13 of Schedule 11 of the Act sets out the detail of this power. 'Discretionary payments' refers to those payments made otherwise than under a contractual obligation and are defined as dividend payments; share buy-backs; equity remuneration; and variable remuneration including, where an employee is a senior manager,^[14] bonuses, discretionary pension benefits and severance payments.

The Act sets out the conditions that the Bank must consider and be satisfied are met prior to giving directions under this power. These conditions are set out briefly below and in detail in Section 3 of this SoP.

The Bank may by direction temporarily restrict or prohibit such discretionary payments to specified shareholders or employees of a CCP for a specified period of no more than five years, and subject to a three-monthly review, under the following conditions ('the conditions'):

- a stabilisation power is not being exercised in relation to the CCP;
- the exercise of the power is necessary or desirable having regard to the public interest in the stability of the UK financial system, or the continuity of critical clearing services; and
- at least one of the following conditions is met:
 - there is or is likely soon to be a significant deterioration in the financial situation of the CCP;
 - there is a material risk of a threat to the ability of the CCP to maintain critical clearing services;
 - there is a risk of a significant disruption to the operation of the CCP; or
 - the operation of the CCP poses a risk to the UK's financial stability.

At least once every three months after giving the direction, the Bank must review whether the conditions for exercising this power continue to be met. Should they cease to be met, the Bank must revoke the direction with immediate effect. The Bank may also make variations to the direction as necessary and at any time provided the conditions continue to be met.

A direction under this power ceases to have effect if the Bank, as Resolution Authority, exercises a stabilisation power in respect of the CCP.

As is the case with any public body in the exercise of its functions, the Bank will have regard to relevant principles of public law, in particular the requirement to act reasonably and in accordance with common law principles of procedural fairness when exercising its power of direction.

3: Approach to giving a direction to restrict or prohibit discretionary payments

The Bank considers that the objective of the conditions is to ensure the power is only used in severe circumstances where the Bank considers that its exercise of the power may mitigate risks to UK financial stability by addressing risks to the continuity of critical clearing services. The Bank's use of the power would seek to improve the financial situation of the CCP by requiring the CCP to retain specific funds, which would help to absorb potential losses in, for example, the scenarios outlined in this section.

As set out in Section 2 of this SoP, a set of statutory conditions must be met before the Bank can give a direction to temporarily restrict or prohibit discretionary payments to specified shareholders or employees of the CCP. These conditions set the scope for the type of severe circumstances in which the Bank might use the power. This section sets out what factors the Bank will consider when assessing whether the conditions are met. These factors are non-exhaustive and the Bank will assess the conditions and take any decision to give a direction on a case-by-case basis. The factors set out in this section could cover a range of scenarios where the Bank would consider exercising the power, but not be obligated to do so. This includes circumstances in which it may be uncertain to what extent the CCP's viability is threatened, ie up to and including the point where losses are incurred. The scope of the statutory conditions that have to be met limit the Bank's use of the power to severe circumstances.

A: A stabilisation power is not being exercised

The first condition that must be met as a pre-requisite for the use of this power is that no stabilisation power is being exercised at the time in relation to the CCP in question. This means that the direction may be given by the Bank up to the point where the Bank, as Resolution Authority, assesses that the CCP meets the conditions for resolution set out in statute and so decides to exercise a stabilisation

power in relation to the CCP in question. The Act also provides an equivalent power (paragraph 102 of Schedule 11), which enables the Bank, as Resolution Authority, to temporarily restrict or prohibit discretionary payments to specified shareholders or employees of CCPs in a resolution context by specifying it as a provision in a resolution instrument, a share transfer instrument, or a property transfer instrument. This SoP, and the approach outlined herein, does not apply to the Bank's use, as Resolution Authority, of the power under paragraph 102.

As soon as the Bank, as Resolution Authority, exercises a stabilisation power in respect of the CCP in question, any direction given by the Bank under paragraph 13 ceases to have effect.

B: Necessary or desirable having regard to the public interest

A further condition that must be met for the Bank's use of this power is that the exercise of the power is necessary or desirable having regard to the public interest in UK financial stability or the continuity of critical clearing services. In assessing whether the use of this power would be necessary or desirable having regard to the specified public interest, the Bank expects to consider whether the exercise of the power would be likely to mitigate risks to the stability of the UK financial system or whether it would be likely to maintain the continuity of critical clearing services.

The Bank expects to consider the maintenance of public confidence in the UK financial system as part of the public interest in UK financial stability. This includes the maintenance of public confidence in markets and the banking and wider financial system which the CCP serves. One factor the Bank may consider in having regard to the specified public interest could be the levels of uncertainty resulting from a stress situation at a CCP. In making its determination, the Bank could consider the presence of significant uncertainty to present circumstances in which the exercise of this power may be necessary or desirable having regard to the specified public interest.

The Bank would also consider whether there is a material threat to the continuity of critical clearing services. Should the continuity of any critical clearing service become threatened, and the Bank considers that the withdrawal of any critical clearing service could create risks to UK financial stability, the Bank would be likely to deem the exercise of this power to be in the public interest. The Bank may

consider using this power in a targeted way by restricting specific types of payments, while allowing other payments to proceed. Here, the Bank may take account of the relative impact of different types of discretionary payments on the financial situation of the CCP. The Bank may also take account of the impact of restricting specific types of discretionary payments, such as equity remuneration, on the operation of the CCP or its ability to maintain critical clearing services. The Bank would consider any impact on a case-by-case basis in line with the statutory conditions.

C: Further conditions, of which at least one needs to be met

In addition to the conditions set out in subsection A and B of this section, to use the power the Bank will need to determine that at least one of Condition I, II, III or IV set out below is met.

Condition I: There is or is likely soon to be a significant deterioration in the financial situation of the CCP.^[15]

Condition II: There is a material risk of a threat to the ability of the CCP to maintain critical clearing services.^[16]

Condition III: There is a risk of a significant disruption to the operation of the CCP.

Condition IV: The operation of the CCP poses a risk to the financial stability of the United Kingdom.

The Bank will consider these four conditions concurrently during its assessment and its determination that at least one of Conditions I to IV is met will be based on the specific circumstances at the time. The Bank considers that there are scenarios that could occur that may result in more than one of Conditions I to IV being met.

A non-exhaustive, hypothetical set of circumstances, which the Bank considers could lead to one, or more, of Conditions I to IV being deemed to be met would include:

- **Major risks to UK financial stability that the Bank judges could transmit to a CCP.** The risk does not need to originate from within the CCP. Contagion risks may transmit stress across markets to CCPs. A historical example where the

Bank may have considered the conditions to be met includes the Covid-19 pandemic – this presented material external risk factors, including uncertainty, which could have resulted in disruption to critical clearing services and risks to UK financial stability. Once it becomes clear at any point that such external risk factors, including uncertainty, are material enough to threaten, or are likely to threaten, the CCP's ability to absorb market shocks and/or to maintain the continuity of its critical clearing services, the Bank may deem one or more of Conditions I to IV to be met.

- **A shock to a CCP that results in material financial losses.** The Bank may consider the exercise of the power appropriate where a CCP experiences a material financial loss that it is required to absorb. The Act provides that a deterioration in the financial situation of a CCP is significant if the deterioration places the CCP at risk of failing or being likely to fail. If, during the Bank's assessment, it becomes clear that the losses are threatening the viability of the CCP or its ability to maintain critical clearing services, the Bank could deem one or more of Conditions I to IV to be met.
- **Unanticipated material general business risks to a CCP.** One or more of Conditions I to IV could be deemed to be met without material financial losses at the CCP occurring. One example could be a breakdown in the systems or processes used by a CCP to operate its services. This could crystallise through a cyber/IT related event which results in the CCP not being able to perform services that are required to maintain the continuity of its critical clearing services and/or which result in a significant disruption to the operation of the CCP. The Bank would likely consider a disruption to the operation of the CCP significant if it has a material impact on the CCP's ability to continue important business services. Where the disruption is significant enough that the CCP may not be able to meet its agreed impact tolerances for important business services, the Bank may consider it a significant disruption to the operation of the CCP.[17]

Approach to the scope of directions

Once the conditions for the use of the power are deemed to be met and the Bank determines that it is appropriate to exercise the power, it will decide the scope of any restriction. This includes the types of payments affected and the duration and

extent to which they are restricted or prohibited. These determinations will depend on the exact circumstances that prompted the Bank to assess whether the conditions are met.

In line with the objective of the power, the Bank only expects to restrict, or prohibit, those discretionary payments where the Bank deems that this action would mitigate risks to the continuity of critical clearing services, and the stability of the UK financial system. An important consideration for the Bank would be the CCP's quantum of funds and how this relates to the range of discretionary payments made by the CCP. It is likely that a CCP's dividend payments to shareholders would be significantly larger than discretionary payments to employees and therefore are likely to have a more material impact on the CCP's capital base. The Bank would expect to consider this a relevant factor when determining the scope of any direction it gives under this power.

It is important that the Bank can exercise discretion to set the scope of any direction on a case-by-case basis, provided that the conditions set out in this section are met, as there are circumstances where restricting certain types of discretionary payments may in fact hinder efforts to maintain the continuity of the CCP's critical clearing services. The Bank may therefore limit the scope of any direction or may determine not to exercise the power despite the necessary conditions being met.

4: Process of giving directions

Once the Bank has decided to exercise the power and has determined which discretionary payments should be temporarily restricted or prohibited, it will issue a formal written direction to that effect. Any direction given under this power can be varied at any time by the Bank. The direction will include the information for the CCP to implement the direction, including among other things:

Reason for the Bank's direction: This will specify the reason the Bank is giving the direction based on the conditions set out in Section 3 of this SoP, eg to mitigate risks to the stability of the UK financial system or to maintain the continuity of critical clearing services.

Duration of the restriction: The direction will also set out how long the restriction(s) for the discretionary payment(s) specified in the direction will be in place. The direction will be in effect up to a maximum period of five years as provided for in the Act. The direction will also include the date by which the direction will be reviewed by the Bank, which must happen at least once every three months while the direction is in force. If, during that time, the Bank becomes aware that the conditions for the exercise of the power cease to be met, the Bank must revoke the direction with immediate effect. The direction will also cease to have effect if, at any point while the direction is in force, a stabilisation power is exercised in respect of the relevant CCP.

Scope of the restriction: The direction will specify the types of discretionary payments that are to be restricted or prohibited by the CCP as well as the shareholders or employees to whom the direction applies.

Provision of direction: The Bank will provide the direction in writing. The direction will specify the shareholders and/or employees that the direction applies to and to whom the direction must be given in writing. The Bank will inform the relevant CCP if the Bank has made a variation to the direction or if it revokes the direction.

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1. References to 'employee' or 'employees' in this CP refer to 'employee' as defined in Schedule 11, paragraph 154 of the Financial Services and Markets Act 2023 (the Act). This includes the holder of an office, such as a director.
 2. References to 'CCP' or 'CCPs' in this CP refer to 'CCP' as defined in Schedule 11, paragraph 154 of the Act. This means a central counterparty in relation to which a recognition order is in force.
 3. As defined in Schedule 11, paragraph 154 of the Act. This means a person who exercises executive functions within the CCP and is responsible, and directly accountable to the directors, for the day-to-day management of that CCP.
 4. The stabilisation powers available to the Bank are (a) the share transfer powers; (b) the property transfer powers; and (c) the other resolution powers (paragraph 1 of Schedule 11 of the Act). These stabilisation powers would be exercised by the Bank, as Resolution Authority, to achieve the stabilisation options that the Bank can employ during a resolution of a CCP.
 5. Paragraph 13(2), 13(3) and 13(4) of Schedule 11.
 6. Within the meaning given by paragraph 7(6) of Schedule 11 of the Act. This means a deterioration that places the CCP at risk of failing or likely to fail.

7. As defined in paragraph 154 of Schedule 11 of the Act, 'critical clearing services' means clearing services the withdrawal of which the Bank considers may threaten the stability of the UK financial system.
8. Section 2A of the Bank of England Act, 1998.
9. Section 149.
10. References to 'employee' or 'employees' in this CP refer to 'employee' as defined in Schedule 11, paragraph 154 of the Act. This includes the holder of an office, such as a director.
11. References to 'CCP' or 'CCPs' in this SoP refer to 'CCP' as defined in Schedule 11, paragraph 154 of the Act. This means a central counterparty in relation to which a recognition order is in force.
12. Schedule 11, paragraph 13 of the Act.
13. Schedule 11, paragraph 154 of the Act defines 'critical clearing services' as clearing services the withdrawal of which the Bank considers may threaten the stability of the UK financial system.
14. As defined in Schedule 11, paragraph 154 of the Act. This means a person who exercises executive functions within the CCP and is responsible, and directly accountable to the directors, for the day-to-day management of that CCP.
15. Within the meaning given by paragraph 7(6) of Schedule 11 of the Act. This means a deterioration that places the CCP at risk of failing or likely to fail.
16. As defined in paragraph 154 of Schedule 11 of the Act, 'critical clearing services' means clearing services the withdrawal of which the Bank considers may threaten the stability of the UK financial system.
17. The Bank's supervisory statement [Operational Resilience: Central Counterparties](#), March 2021, sets out the Bank's expectations for CCPs to be resilient to operational disruption events.